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Schwarzenegger Deficit-Reduction Plan Flawed: LAO Report

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By [Rich Saskal](#)

SAN FRANCISCO - The financial projections California Gov. Arnold Schwarzenegger used to develop his May Revise budget proposal are sound and reasonable, though the solution he proposed for closing the state's budget deficit are not, according to a [report released yesterday](#) by the state's independent Legislative Analyst's Office.

The nonpartisan LAO issues a review of every state budget proposal.

The big news from the last week's May Revise budget proposal for fiscal 2009 was a plan to securitize lottery revenues while "modernizing" the state lottery to increase sales. It was twinned with a contingency plan to increase the state sales tax should changes to the lottery fail to achieve the necessary voter approval.

The LAO largely echoed the Schwarzenegger administration's view of the state's revenue picture, revising revenue forecasts for fiscal 2009 downward by about \$6 billion.

"Our current- and budget-year economic and revenue forecasts are similar to those of the administration. For both forecasts, economic growth is expected to stay minimal until mid-2009 and begin to strengthen thereafter, with our

forecast providing a somewhat faster revenue bounce-back," the report said.

"Our revised economic forecast is slightly more pessimistic than that of the administration," according to the LAO. "As a result, our estimate of revenues totals about \$300 million less than the administration's over the current and budget years combined - a minor difference, given the state's general fund revenue base of roughly \$100 billion."

But the LAO disagreed with Schwarzenegger's approach to solving the budget gap.

The governor wants voters to approve a plan that would allow the issuance of bonds securitizing future lottery revenues. The governor wants to authorize up to \$15 billion of borrowing over three years in a proposal tied to a budget reform plan he introduced earlier this year. Lottery bond proceeds would flow into a rainy-day fund, though the \$5.1 billion of bonds the governor would issue in fiscal 2009 would be used immediately for that year's budget.

The LAO said the governor's lottery plan entails "significant risks," and proposed an alternative with much less borrowing.

The lottery currently generates about a \$1.2 billion annual surplus, which flows to education. Schwarzenegger says that by more than doubling lottery sales, his plan would keep education funding while generating enough revenue to service the \$15 billion debt, though education funds would be subordinate.

"Our major concern with the governor's plan, however, is that it makes overly optimistic and potentially unobtainable assumptions about the ability of the lottery to increase its profits," the report said. "Therefore, there is a very strong likelihood that distributions to public education would fall well short of

the \$1.2 billion per year targeted by the administration, and this could result in new spending pressures for the general fund."

As an alternative, the LAO proposes to raise \$5.6 billion over two years through lottery bonds.

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